Journal of Sustainable Finance & Investment

ISSN: 2043-0795 (Print) 2043-0809 (Online) Journal homepage: http://www.tandfonline.com/loi/tsfi20

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To cite this article: Frank AJ Wagemans, CSA (Kris) van Koppen & Arthur PJ Mol (2018): Engagement on ESG issues by Dutch pension funds: is it reaching its full potential?, Journal of Sustainable Finance & Investment, DOI: 10.1080/20430795.2018.1485379

To link to this article: https://doi.org/10.1080/20430795.2018.1485379

Published online: 18 Jun 2018.

JOURNAL OF SUSTAINABLE FINANCE & INVESTMENT
https://doi.org/10.1080/20430795.2018.1485379

Engagement on ESG issues by Dutch pension funds: is it reaching its full potential?

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ABSTRACT

In socially responsible investment (SRI), engagement forms one of the core strategies of institutional investors. In investigating the case of Dutch pension funds, this study answers the following questions: what networks shape engagement with investees, and what factors determine the effectiveness of engagement? The methods we used were interviews and a multiyear survey. Engagement was practised by 82% of the largest Dutch pension funds in 2016 and was implemented by asset managers and service providers. However, these actors are isolated from actors outside the financial sector. The legitimacy of the investor influences the effectiveness of engagement, whereas the number of shares is less important. The relationship between the engager and investee and the receptivity of the investee towards engagement are also of importance. Engagement can be made more effective when pension funds focus on specific themes, target companies open to engagement, and also seek collaboration with societal and policy actors.

ARTICLE HISTORY
Received 17 August 2017
Accepted 4 June 2018

KEYWORDS
Responsible investment; shareholder engagement; ESG; pension funds; Socially Responsible Investment; SRI

1. Introduction

Socially responsible investment (SRI) is on the rise, with total global investments reaching $22.89 trillion at the beginning of 2016 (GSIA 2017). SRI can be implemented by strategies such as exclusion; the integration of environmental, social, and governance (ESG) criteria; engagement; or impact investing. This study focuses on engagement, which has been shown to potentially improve ESG performance (Wagemans, van Koppen, and Mol 2013). Engagement is the core SRI strategy among institutional investors who want to discuss ESG concerns without publicising these concerns, as would occur in shareholder voting (Solomon, Solomon, and Suto 2004; Vandekerckhove, Leys, and Van Braeckel 2007). We will use the following definition of engagement:

> *Engagement refers to interactions between the investor and current or potential investees on ESG issues. Engagements are undertaken to influence (or identify the need to influence) ESG practices and/or improve ESG disclosure (PRI 2015).*

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In Europe, engagement is rapidly growing. Engagement policies are in place, with investments totalling 2 trillion euros, and an average asset manager engages 100–200 companies annually (Eurosif 2013).[1] Although the emphasis in the US is more on voting and filing proposals at annual shareholder meetings, there, too, engagement grew by 29% from 2009 to 2012, from $3.8 trillion to $4.9 trillion (USSIF 2013) (see note 1).

Prior research on SRI has often focused on the relationship between SRI and financial returns; examples include studies by Capelle-Blancard and Monjon (2012), Derwall et al. (2005, 2011), Renneboog, Horst, and Zhang (2008) and Vogel (2006). In a meta-study of 2200 empirical studies, Friede, Busch, and Bassen (2015) found that in 90% of these studies, there was a non-negative relationship between ESG and corporate financial performance, with the large majority being positive.

Other studies have investigated other SRI strategies, particularly shareholder voting, such as works by Monks, Miller, and Cook (2004), Tkac (2006) and Sparkes and Cowton (2004), who all studied voting practices in the US. Screening and exclusion have been studied by Aslaksen and Synnestvedt (2003) and Haigh and Hazelton (2004), among others. Both studies evaluated the effectiveness of screening and exclusion in relation to the 'cost-of-capital' argument.

With regard to engagement, there is a small but growing number of studies investigating its application and effectiveness in improving ESG performance among investees. We provide an overview of these studies to identify research gaps and research questions.

Dimson, Karakaş, and Li (2015) studied the engagement practices of a US-based asset manager and addressed a wide range of questions: which companies are engaged; are these engagements effective and how do investees and markets respond to engagements? The main conclusions are that engagement leads to better financial performance of the investees and that co-operation on engagement leads to a higher rate of success.

Bauer, Clark, and Viehs (2013) studied the role of geographical factors in the intensity and effectiveness of engagement. They did so by taking the perspective of a UK-based asset manager. Their main finding was that there is a home bias for selecting engagement cases, but that, surprisingly, engagements in the home market were less successful. In addition, larger firms and firms that previously were engaged are more likely to be engaged. Additionally, pooled engagements were shown to have a high success rate.

Ferraro and Beunza (2014) performed a qualitative analysis of the engagement and filing of resolutions of a leading American coalition of faith-based investors. They used the concept of 'voice' developed by Hirschman (1970) to analyse how members of this coalition raise their concerns with management. Goodman et al. (2014) also used the concept of voice in analysing the engagements of faith-based investors and investigated factors that influence effectiveness, in particular, potential divestments from the investees involved. Both studies found that this coalition of investors has an influence through engagement that is disproportionate to the size of their investments based on their methods and reputation.

Several researchers have used the theory of stakeholder salience to study engagement and its effectiveness. Stakeholder salience explores the comparative level of salience of stakeholders towards decision makers, such as corporate managers. According to stakeholder salience theory, three attributes determine the level of salience of a stakeholder, such as a shareholder: power, legitimacy and urgency. Power is the ability to control resources. Legitimacy is linked to the social acceptance of issues and the way issues are raised.

Urgency refers to how urgent claims of stakeholders are (Mitchell, Agle, and Wood 1997; Gifford 2010, 2012).

Vandekerckhove, Leys, and Van Braeckel (2007) were among the first to apply the theory of stakeholder salience to the engagement process. They investigated the attitude of management towards engagement. They did so by studying the corporate responses to letters sent by Portfolio 21, a joint collaboration of continental European investors. They found that in these responses, investees are willing to start engagement but will not necessarily acknowledge the concerns raised by the investors.

Allen, Letourneau, and Hebb (2012) studied the engagement process between Northwest & Ethical Investments and Barrick Gold in the period of 2005–2009. They applied stakeholder salience theory to the engagement process and reported that legitimacy is an important factor that controls the effectiveness of engagement.

Magness (2008) also applied stakeholder salience theory to investigate the role of shareholders and management. He investigated the responses of management and shareholders to two incidents in the mining industry. Although the shareholders were investigated mainly through a financial lens in relation to share returns, the study also yields valuable lessons for the application of stakeholder salience to engagement. A core conclusion is that stakeholder salience is not absolute but rather is determined by the decision maker.

Hamilton and Eriksson (2011) applied stakeholder salience theory to the shareholder engagement of Swedish pension funds. Interestingly, they applied stakeholder salience to explain how Swedish pension funds chose their strategy of influencing their investees. A main conclusion is that reputation risks are an important consideration that has induced Swedish pension funds to practice engagement.

Gifford (2012) applied stakeholder salience in case studies of engagement by one US- and two UK-based institutional investors. His detailed application of salience theory to engagement practices is arguably the most in-depth framework for studying the effectiveness of engagement available to date. From his case studies, he concluded that the theory of stakeholder salience has validity for assessing the effectiveness of engagement practices, but that legitimacy, power and urgency do not need to be present simultaneously, and not all three factors have the same level of importance.

When analysing these studies, we can identify two important knowledge gaps. First, the existing studies focus on the direct contact of engagers with investees. However, engagement is shaped and coordinated by a network of actors establishing engagement policies, providing information and implementing the actual engagement policies. Second, the existing studies cover data and viewpoints of institutional investors and asset managers in particular when studying the effectiveness of engagement but not the perspective of the investees that are engaged. However, insights of the investees are key in determining the factors that influence the effectiveness of engagement.

In contributing to filling these knowledge gaps, this research addresses the following research questions:

(1) Which networks steer the engagement process of institutional investors?
(2) Which factors determine the effectiveness of the engagement of institutional investors in improving ESG performance among their investees?

In answering the second question, we will address the second research gap and explicitly take the perspective of the investees into account.

In investigating these questions, we have chosen the Dutch market as the focus of the study. The Netherlands has a well-developed SRI market for individual and institutional investors (Quak, Heilbron, and Meijer 2014; Scholtens 2005). Specifically, the Netherlands is the second most active European country in engagement after the UK (Eurosif 2010).

Pension funds were chosen as an additional focus of this study because they are the largest source of institutional investor engagement. In Europe, pension funds constitute 63.3% of all SRI assets (Clarke and Hebb 2004; Eurosif 2010). The Dutch pension fund sector plays a relatively large role in the Netherlands, which is the nation with the highest pension investments relative to its economy: 178.4% of the GDP (OECD 2016). In 2017, these assets under management reached 1346 billion euros (DNB 2018).

These assets under management are governed by 243 Dutch pension funds that organise pensions for (former) employees of specific companies, economic sectors or professions (DNB 2016). The board of a pension fund formally sets the policies, including those for SRI and engagement, and is composed of employee representatives (labour unions), employers and, since 2014, external experts. The board is advised by several advisory councils, including one with representatives from the participants of the fund (Pensioenfederatie 2010; Wetten.Overheid.nl 2016).

This paper is structured as follows. The following section introduces the main concepts and methods used in this study. The findings are presented in sections 3, 4 and 5, followed by discussion and conclusions in section 6.

2. Concepts and methods

To analyse the organisation and networks of engagement, we use social network theory. To analyse which factors determine the effectiveness of engagement in stimulating ESG performance among investees, we build upon previous studies of salience, in particular, work by Gifford (2012).

2.1. Social network analysis

Social network analysis is closely linked to graph theory, and over the years, a robust methodology has been developed to graphically represent social networks (Löblich and Pfaff-Rüdiger 2011; Borgatti et al. 2009; Butts 2009). As this is an explorative study, we use a very basic, qualitative form of social network analysis to depict the relations between actors in engagement processes as derived from interviews. In doing so, we use two perspectives on networks and their actors in relation to engagement practices. First, we analyse actors that have a direct role in implementing the engagement process. Second, we focus on the relations between these actors and governmental and societal actors. To this end, we work in the context of the triad network model, which was originally developed to analyse and map empirical processes of ecological modernisation (Mol 1995). The triad network model is rooted in the structuration theory of Anthony Giddens (1984) and identifies three distinct but interdependent networks that together influence companies or industrial sectors central to the analysis: an economic network, a policy network and a social network. Each network has its own analytical perspective,

specific institutional arrangements and a particular set of actors. A social network focuses on the relationships of companies with civil society, a political network investigates relationships from a political-administrative perspective between companies and state and regulatory actors, and an economic network focuses on financial and economic transactions between private economic actors (Mol 1995). By using the triad network model, we analyse and provide insight regarding the extent to which the economic, policy and societal networks play a role in shaping and implementing engagement processes.

2.2. Shareholder salience

To examine if and when engagement is effective in stimulating reform, we build on the theory of 'stakeholder salience' developed by Mitchell, Agle, and Wood (1997) and refined and applied to shareholders by |Gifford (2010, 2012). Although salience cannot be equated with effectiveness per se, previous studies have demonstrated that salience plays an important role in the effectiveness of engagement (Gifford 2010; Allen, Letourneau, and Hebb 2012).

Gifford refined and adapted stakeholder salience specifically for shareholder engagement. An overview of that adaptation is provided in Table 1 and is explained in detail below. Gifford refined the role of power by building upon the work of Scott (2013) and Mitchell, Agle, and Wood (1997). Power can be subdivided into coercive, utilitarian or normative means for imposing the will of a shareholder on an investee (Gifford 2010). Gifford and Mitchell refined the role of legitimacy by building upon the work of Suchman (1995) and Scott (2013). Legitimacy is defined as '*a generalised perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions*' (Scott 2013).

Table 1. Sources of shareholder salience (based on Gifford (2012).

Sources of shareholder salience	Dimensions or forms	Explanation
Power	Coercive	Use of shareholder rights: shareholder resolutions, votes against management, director elections
	Utilitarian	Use of economic power: divestment (or investment)
	Normative	Use of the media and/or public statements or peer pressure; public shareholder campaigns; threats to reputation
Legitimacy	Individual	Credibility of the individuals: seniority, experience and expertise; ability to develop trust and collegiality
	Organisational	Status of the engaging organisation: degree to which a shareholder is perceived to be 'mainstream'; perceived alignment of interests between a shareholder and the company; organisational alignment and consistent messaging
	Pragmatic	Strength of the business case: validity of the argument; evidence; extent of new information provided to the company; maturity of the issue
	Societal	Strength of the societal case: social and cultural context; existence of legitimising standards, norms and principles Political/policy context: supportive political environment; regulatory momentum
Urgency	Time sensitivity	Deadlines, benchmarks
	Criticality	Intensity of private engagement activities: assertiveness and persistence

Based on Wood (1991) and Suchman (1995), Gifford identified four forms of legitimacy, i.e. individual legitimacy, organisation legitimacy, societal legitimacy and pragmatic legitimacy, pragmatic legitimacy being legitimacy from the perspective of the company (see Table 1 for the adaptation to shareholder engagement). Urgency is the third attribute and relates to how pressing and critical a claim is for a stakeholder (Mitchell, Agle, and Wood 1997). Gifford (2010) subdivided this urgency into the time sensitivity of a claim and the intensity of engagement activities. However, more intensive engagement does not necessarily cause the claim to be more urgent from the investee's perspective.

In addition to this framework, Gifford (2010) and Driscoll and Starik (2004) found four so-called moderating factors, discussed below, that are not associated with the power, legitimacy and urgency attributes but that can influence those attributes positively or negatively.

2.2.1. Relative economic and governance power: size of the stake, investor and firm

Gifford (2010) identified the size of the stake and the overall size of the investor as moderating factors of power and legitimacy.

2.2.2. Coalition building: leveraging other investors, NGOs and policy makers

Coalition building can be a method of increasing salience. Coalitions can be formed among investors but also with NGOs or policy makers to combine and strengthen their salience over the three criteria (Magness 2008; Mitchell, Agle, and Wood 1997; Gifford 2012).

2.2.3. Values of managers: degree of alignment with investor request

This attribute relates to the attitudes of managers in response to requests made during the engagement process. Agle, Mitchell, and Sonnenfeld (1999) and Gifford (2012) identified the role of the company involved by identifying the moderating factor 'Values of managers', which highlights the role of the managers of the engaged company in relation to salience. The relevance of the company for the effectiveness of engagement was also addressed by Vandekerckhove, Leys, and Van Braeckel (2007).

2.2.4. Proximity

Driscoll and Starik (2004) identified the moderating factor 'proximity', which they translate as the proximity of the actors from a network perspective. However, Neville, Bell, and Whitwell (2011) argued that proximity is an important factor, but it is part of the power attribute, through the position of a stakeholder in the network, and part of the legitimacy attribute.

2.3. Methods

Quantitative studies have dominated the field of business ethics (Campbell and Cowton 2015). However, we have chosen a qualitative approach combined with quantitative data. Because most engagement occurs behind closed doors, and limited information is disclosed, a qualitative approach based on semi-structured interviews provided us the opportunity to explore with the interviewees the factors that make engagement effective, how different actors shape engagement and to go into more detail if they

presented us with new inroads and perspectives. In addition to data from interviews, quantitative data from yearly studies (over nine years) of the SRI practices of the 50 largest Dutch pension funds were used.

2.3.1. Quantitative data

The dataset from nine editions of the yearly 'Benchmark Responsible Investment by Pension Funds' by the VBDO (Dutch association of investors for sustainable development) was used to identify trends in the engagement practices of Dutch pension funds (VBDO 2016, 2015, 2014, 2013, 2012, 2011, 2010, 2009, 2008, 2017). This benchmark study of responsible investment by pension funds has been completed for nine consecutive years and covers the governance, policies, implementation and transparency of SRI practices. The data used are evidence-based and provided by the 50 largest Dutch pension funds. Subsequently, this information is verified by the VBDO. If a pension fund does not provide data, the data are retrieved from secondary sources such as the annual responsible investment report. However, there have been high response rates among the 50 largest pension funds: 94% in 2016, 100% in 2015 and 100% in 2014. The data have been supplemented with secondary literature such as annual reports of companies and pension funds, media reports and publications related to engagement.

2.3.2. Interviews

To gain insight into the effectiveness of engagement, quantitative data alone are not sufficient. Therefore, 23 interviews were conducted with a broad range of relevant actors related to the engagement practices of Dutch pension funds. A semi-structured questionnaire was used in all interviews; this questionnaire was modified based on the type of actor being interviewed. The questionnaire on engagement activities was based on salience theory, and the interviewees were asked specific questions about their actions and their networks, based on the triad network approach. All interviews were conducted on a confidential basis to ensure that respondents could talk freely, and the results are only provided in anonymised form in this article. The interviews were transcribed and systematically coded. On average, the interviews lasted 1 h. The interviewees can be divided into two main groups.

2.3.3. The network in and around Dutch pension funds

Ten interviews were conducted with actors setting engagement policies and implementing engagement for Dutch pension funds. The pension funds, asset managers and engagement providers were selected in two steps. First, a selection was made of the pension funds, asset managers and engagement providers who were most active in SRI and engagement according to the benchmark report of the VBDO. Second, an additional selection was made to ensure that the interviewees represented a diverse range of small and larger pension funds, asset managers and engagement providers. All the interviewees that were approached for an interview accepted the invitation. This process resulted in three interviews with asset managers, two with pension fund board members and support staff, three with specialised ESG and/or engagement providers and two with actors from an umbrella organisation coordinating engagement practices of institutional investors.

Three additional interviews were conducted with experts from NGOs (1) and research organisations working on pension funds (2).

2.3.4. Companies who are engaged by Dutch pension funds

The companies were selected based on the suggestions of the interviewed pension funds and asset managers and based on mentions in the annual engagement reports. A further selection was made to ensure that the interviewees provided a broad spectrum in relation to ESG performance and sectors. Because the investments of Dutch pension funds and engagement cases are globally diversified, a second selection was made to ensure that the interviewees represented this geographic diversification.

Thirteen public companies engaged by Dutch pension funds were approached, of which ten accepted the interview request. The interviewees represented companies in eight countries. These interviews were performed with representatives involved in the engagement process, mainly from the investor relations and the sustainability departments. The interviews with the Dutch companies were performed face-to-face, and those performed with the other companies were by telephone.

3. Organisation and network of engagement of Dutch pension funds

In this section, we provide an overview of how engagement is organised and which actors are involved. We use the triad network approach to analyse and identify the relations among pension funds and actors in the economic, policy and societal networks.

3.1. Economic network

The boards of the pension funds set the SRI and engagement policies, but the implementation of the policies and investment management, including engagement, are outsourced to a range of actors in the economic network. Based on interviews, the underlying data of the VBDO benchmark and secondary data, we provide an overview of the actors involved.

Asset management is outsourced to a fiduciary and/or asset manager(s). This asset manager may work solely for one pension fund or provide services to multiple funds (Pensioenfederatie 2010, 2016). The procedures regarding engagement are more complex. For some pension funds, the asset manager also implements the engagement process. In these cases, engagement with ESG and financial themes can be integrated and implemented by the same team, although implementation can also be performed by separate teams. At some pension funds, specific ESG service providers, such as Hermes, BMO and Robeco, conduct the actual engagement conversations regarding ESG themes independently from the asset manager.

In addition, asset managers, ESG service providers, and ESG data providers such as Sustainalytics, Vigeo-Eiris and MSCI are relevant actors in engagement practices. These agencies gather ESG information that is used in the selection and preparation of engagement cases, but the data are also used for other SRI strategies, such as exclusion and ESG integration. An overview of this network is shown in Figure 1.

The interviewees and quantitative data shed more light on the roles and relationships among the pension funds and the organisations implementing their policies and asset management. Notably, asset managers and ESG service providers, in addition to their role in implementation, play an important role in formulating these policies on behalf of the pension funds they service. The quantitative data indicate that all 50 of the

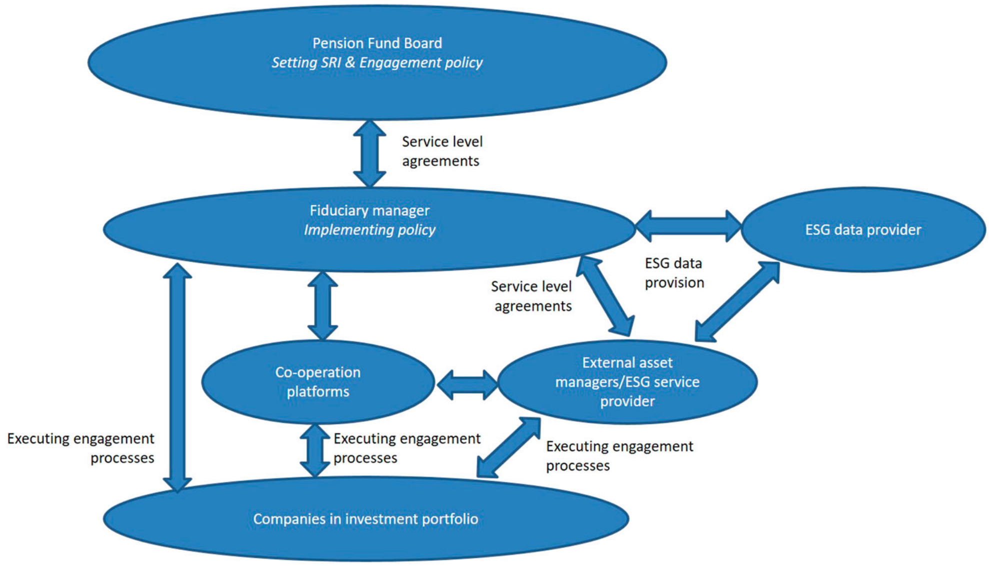

Figure 1. Main actors in the engagement process.

largest funds are advised by their asset manager(s) or ESG service provider in developing the SRI and engagement policies of the fund, and 56% of the funds do not use any other sources or stakeholders to establish those policies.

> *We as a pension fund largely base the choice to engage certain firms or to engage on specific topics on our ESG service provider. They engage with 400 companies worldwide based on a general policy and on the Principles for Responsible Investment. Most pension funds have a policy that is compatible with these principles. We [pension fund board] can also file a specific request to engage a certain firm, although that does not happen often. – Board member pension fund*

A core reason for the strong role of asset managers and ESG service providers is that they possess the expertise needed to formulate and implement SRI and engagement policies. Boards or the support staff within pension funds possess less of this expertise. Knowledge of SRI is not part of the formal requirements set by the supervisor, the Dutch Central Bank (DNB), for board members of pension funds (DNB 2012).

3.2. Platforms and co-operation in the economic network

Engagement is not performed in isolation, and in the interviews, three forms of co-operation between asset managers and ESG service providers were noted.

3.2.1. Co-operation at the country level

Dutch pension funds and their asset managers co-operate on a structural basis with other Dutch institutional investors in their engagement with Dutch listed companies through Eumedion (Eumedion 2018). Eumedion began as a platform for institutional investors to address corporate governance, environmental and social topics.

3.2.2. Co-operation through the asset manager or ESG service provider

Asset managers and ESG service providers often serve multiple Dutch pension funds and other clients. Therefore, the engagement efforts of pension funds and other institutional investors are, to a large extent, bundled. In their engagement, they therefore represent several pension funds and other clients.

3.2.3. Co-operation on specific cases

In addition, co-operation on specific engagements occurs between asset managers and engagement providers that serve different pension funds. Asset managers and engagement providers, for example, share information or combine their engagement efforts towards a certain company or on a specified theme. From the interviews with the asset managers and ESG service providers, it became clear that there is no sense of competition between the asset managers in the field of SRI; rather, best practices and ideas are shared.

> *This is not a topic (engagement) on which it is rewarding to compete. It is not like that when there is a success, somebody can claim that it's his or her success. We compare notes and email each other (engagers). Fortunately, we have the same ideal, because we would be nowhere without collaboration. – ESG service provider*

On the international level, several platforms exist for co-operation that are used by Dutch pension funds, asset managers and ESG service providers in specific cases. One example is the collaboration platform of the Principles for Responsible Investment (PRI), in which asset managers can propose an engagement case in which they want to join forces with other asset managers (PRI 2018).

3.2. Societal network

The actors implementing engagement and platforms for co-operation are logically concentrated in the economic network. Less co-operation and contact occurs between those actors and actors inside the societal network. Based on the quantitative data from the VBDO benchmark, two-thirds of the 50 largest Dutch pension funds did not have any contact with societal actors, such as NGOs, in 2014. In addition, 7 out of 7 interviewees who practise engagement stated that they are not working on a structural basis with NGOs. In the interviews with pension funds, three important reasons were given for the low levels of contact with NGOs.

- NGOs have a different agenda that does not align with the agenda of the pension funds.
- If the pension fund were to work too closely with NGOs, the fund could be perceived as a political organisation and therefore in breach of its fiduciary duty.
- The information NGOs provide does not match the standardised way ESG data are supplied and analysed. Investors favour quantified information as commonly used in research on financial themes by investors, whereas NGOs use more qualitative research data and case studies.

Nevertheless, several examples were mentioned in the interviews, in which interactions and the sharing of information between pension funds and NGOs occurred, because, for specific topics, NGOs were viewed as more knowledgeable or more able to verify the worldwide actions of a company.

I spoke with an NGO of the local population. It is good to talk to company B, but what it tells is in the interest of this company B. We want to get the whole picture, so we also talk to NGOs. – Asset manager

The interviewed asset managers and pension funds also mentioned that NGOs can be perceived as indirectly setting the agenda for pension funds, and ESG data providers are monitoring NGO actions, reports and activities.

The participants of the pension funds, the majority of the Dutch workforce, form another important component of the societal network. Those participants play a limited role in setting SRI and engagement policies; in 2014, for example, the quantitative data show that only 28% of the pension funds had consulted their participants in some way regarding their SRI policies. When consultation occurred, it was generally conducted by means of a small questionnaire or by organising meetings with participants.

3.3. Policy network

In the interviews, no policy actors were perceived as very relevant for stimulating and shaping engagement by Dutch pension funds. This pattern also becomes clear when studying Dutch regulations on SRI and engagement. Currently, two laws are in place for pension funds with a link to SRI. One is an obligation to ban investments in cluster ammunitions, which is overseen by the AFM, the Authority for the Financial Markets (AFM 2016; Overheid.nl 2016a). The other is the legal obligation for pension funds to report on their SRI policies and activities (Overheid.nl 2016b). However, in that law, no specifications exist regarding how reporting should occur and how extensive it should be. It is therefore unclear whether and how this extends to reporting on engagement. The DNB is the main supervisor of Dutch pension funds but, to date, has not played a role in stimulating or shaping SRI and engagement in Dutch pension funds. This could possibly change in the future, as the DNB views sustainability and SRI as part of its mandate and may play a more prominent role in these themes (DNB 2015). Pension funds are represented by the 'Pensioenfederatie', an organisation that represents the pension fund sector and develops sectoral policies and guidelines. The Pensioenfederatie has developed a service document regarding SRI that focuses on the process by which pension funds can develop SRI policies and be transparent regarding such policies (Pensioenfederatie 2016).

In summary, as show in Figure 2, the implementation of engagement is performed by a specialised network of economic actors. Among those actors, co-operation occurs through several platforms or by ad hoc co-operation. Pension funds themselves do not engage directly with their investees but only indirectly through their asset managers and ESG service providers. The role of societal and policy actors is limited and indirect.

4. Main trends in SRI engagement

The interviewed board members and asset managers considered 2007 the starting point for pension funds in relation to SRI and engagement. Most pension funds either began responsible investment that year or intensified their activities. The quantitative data (Figure 3) reveal strong growth in SRI policies and in the practice of engagement since this time. In 2016, 82% of the pension funds practised engagement, and 98% had an

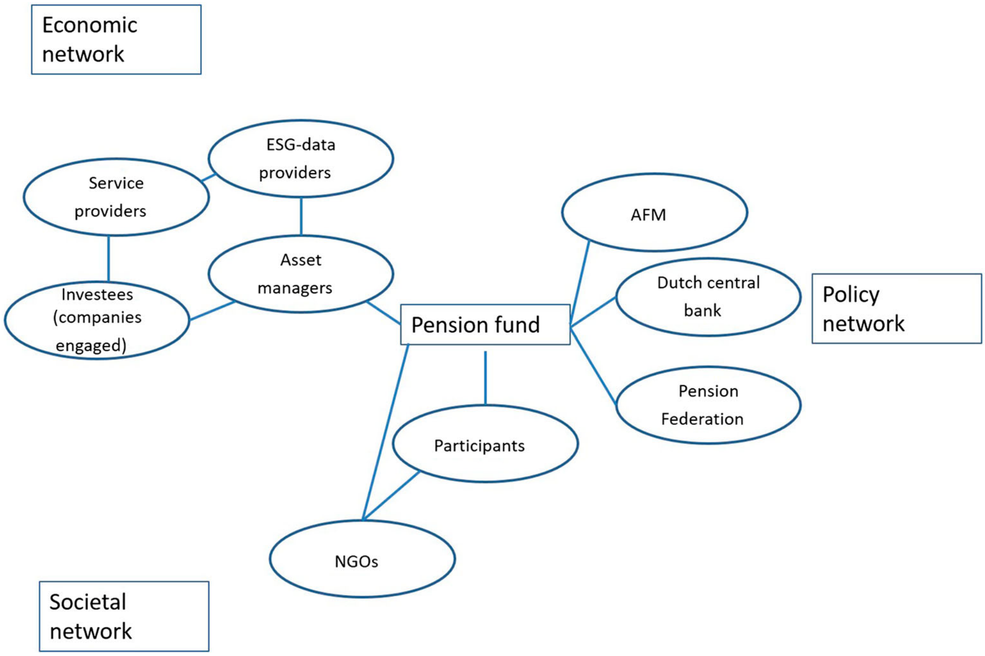

Figure 2. Actors involved in the implementation of SRI and engagement.

SRI policy, an increase from 2007, when 33% of the funds practised engagement and 20% had a formal SRI policy. SRI was also increasingly on the agendas of the boards of pension funds, with 100% of the 50 largest Dutch pension funds placing SRI on the agenda at least twice in 2016, as opposed to only 30% in 2012.

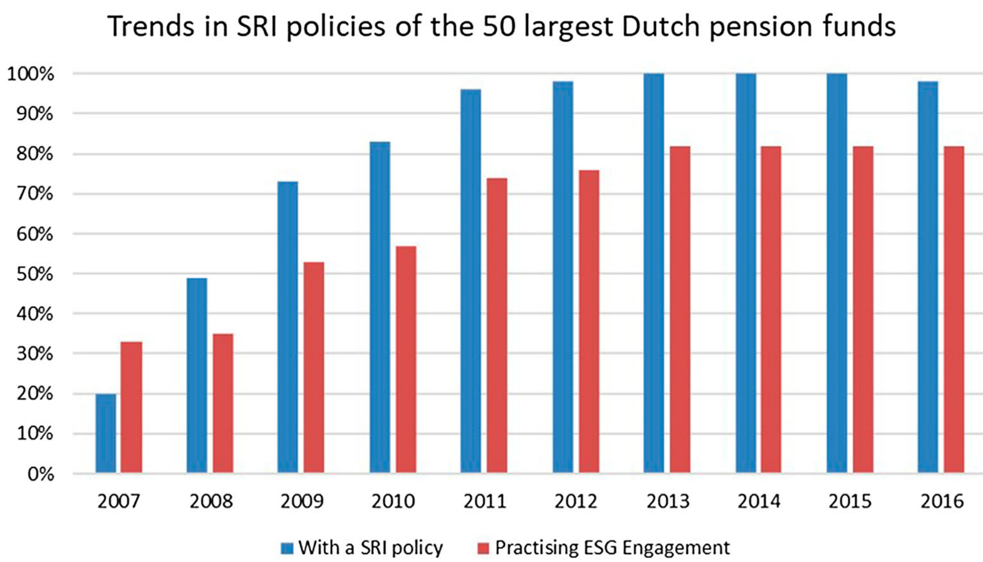

Figure 3. Trends in the SRI policies of the largest Dutch pension funds. Source: compiled by the authors based on the benchmarks of the VBDO.

Notably, among the 50 pension funds in the benchmark, the extent of their policies and engagement activities varies widely, from pension funds having detailed thematic engagement policies to funds only using engagement as a precursor for exclusion in relation to a possible breach of their exclusion policies. The extent of engagement activities also varies, from funds with under 10 engagement meetings on ESG themes to pension funds with hundreds of engagements on a yearly basis. For example, ABP, the largest Dutch pension fund, had 199 engagements in 2015, covering issues including oil drilling in the Arctic, electricity production from coal, child labour and the use of nuclear power (ABP 2016). Pension fund PFZW had 374 engagements in 2015, ranging from sustainable agriculture to labour rights in the agricultural sector to drilling in the Arctic (PGGM 2016).

The interviews revealed that ESG issues are increasingly not perceived as opposed to financial interests and are often integrated into engagement practices. Asset managers and pension funds use engagement, especially for cases in which environmental management or sustainability generally adds shareholder value, such as reducing water use in oil drilling activities or decreasing energy use. In this regard, pension funds commonly use the term 'materiality', indicating that ESG concerns are seen as financially relevant.

> *For us, the idea of engagement is to stimulate better behaviour of companies in the longer term. We have the conviction that when a company performs better in the field of sustainability that this adds shareholder value. – Asset manager*

5. Factors governing effective engagement

Although engagement is increasingly common among pension funds, does it also improve ESG performance in investment portfolios? Below, we discuss the factors that emerged from the interviews with the engagers and investees, such as the factors related to the engager,[2] factors related to the investee and factors related to the relation between the two.

5.1. Factors related to the engager

When are engagers able to connect with and influence the investee? First, the credibility of the engaging organisation was an important condition for effective engagement. As institutional investors, pension funds were in principle considered credible partners in the engagement process by the companies, as their interests are financially aligned with the companies they engage.

> *Institutional investors do not need to put a lot of pressure on us like some NGOs do; they are fairly reasonable because they want a win-win situation. – Company representative*

In addition, the preparation of the engager and framing of the engagement questions were important to effectively exerting influence. Does the engager have a good grasp of the topic and an understanding of the business model due to experience or solid research? However, 7 out of 10 companies engaged stated that at the moment, a lack of preparation by engagers was often hampering constructive dialogue, and questions were often perceived as too superficial.

I want parties to do good research, but their research is mostly rudimentary. Some do not even look at our press releases. They just read their normal newspaper and use that as the basis to respond on. – Company representative

One operationalisation of successful preparation was the importance of linking ESG improvements with the core business model. In the interviews, the companies and engagers rated constructive dialogue with engagers who understood and supported their core business model as more constructive and therefore more successful.

An important consideration relating the concept of power to shareholder salience is whether those using their formal rights are more powerful and thus more effective engagers. The answer to this question is mixed and nuanced. The interviewees stated that possible divestments or votes against certain proposals at shareholder meetings were not considered a major factor in salience vis-à-vis companies. None of the 7 interviewees practising engagement could present examples of the use of voting at shareholder meetings to change company policy. Interviewees did not view this as a potentially powerful method of enforcing their demands because when this step is considered, the company is not considered open to engagement. In addition, companies did not perceive (intended) divestment as a powerful tool that would force them to change. One company even suggested that investors should divest if they cannot identify themselves with the corporate strategy and are considering divestment.

However, in addition to formal rights, a share in a company can be of use in a more indirect way. A legitimate claim associated with owning a large stake in a company was considered relevant by 5 of the 10 investee companies to gaining access to and the attention of a company, as the quotation below illustrates.

We respond to everybody. But, of course, you sometimes have to listen if a shareholder, for example, holds 20% of the company. – Company representative

Nevertheless, the other 5 of the 10 investee companies perceived nuance in the importance of the size of the shares and viewed the credibility of an organisation as more important than the actual percentage of shares owned because the number of shares in a company normally fluctuates, and an asset manager who is not a shareholder today can become so in the near future. Large pension funds, whether actual investors or not, were therefore always considered relevant.

In relation to urgency, an important question is whether the choice of a specific salient or pressing topic influences the effectiveness of engagement. The answer to this question is also mixed. Time sensitivity in relation to, for example, the connection to shareholder meetings was mentioned by none of the 10 investee companies as a major factor related to effectiveness, although it is impossible to know whether this was not mentioned as a factor due to its low effectiveness or because it is not currently practised. In addition, the use of deadlines in engagement, for example, in relation to benchmarks or inclusion in an index, was not mentioned as a factor by the interviewees.

5.2. Factors related to the relationship between the engager and investee

In addition to the factors related to the engager and closely linked with shareholder salience, the relationship between the shareholder and investee was identified as a major

factor. Three important subfactors were identified: the type of contact, the form in which engagement occurs and the (cultural) proximity.

First, the type of contact and the duration and intensity of engagement were considered important. All 10 investee companies stated that engagement in a strong, long-term relationship with the engagers was more likely to be successful due to increased trust, knowledge sharing, and therefore more in-depth discussion between the engager and company. In short-term contacts, a company was more focused on informing the engager than discussing potential changes in ESG performance.

The dialogue definitely becomes better when engagement is taking place regularly; it also makes it easier to understand the business, and that improves the quality of the dialogue. – Company representative

Engagement can take several forms, from sending letters to opening dialogue. The interviewees stated that questionnaires, in particular, are not considered effective. Questionnaires are perceived as time consuming and are viewed by companies as a way of informing investors instead of provoking increased ESG performance within the company. In-depth meetings are considered the most effective, especially when they are well prepared and when questions and demands are communicated beforehand to the company.

For us, a real conversation is best to see through nuances and fully understand each other. That is, a better way to engage than by written communication. – Company representative

In relation to the type of contact, the cultural proximity between the engager and company was also considered important. Five of the 7 interviewees that practise engagement stated that differences in (corporate governance) cultures played a role in the effectiveness of engagement. Engagers active in the same corporate governance culture and region were therefore considered more effective, as the quote below illustrates.

Sometimes, engagement questions are not well adapted to the context of a specific country and do not take another cultural context into account. – Company representative

5.3. Factors related to the investee

The receptivity of the engaged companies was identified as a third group of factors related to the effectiveness of engagement. Receptivity or openness towards engagers was viewed as especially important and as varying among companies, as the quote below illustrates.

We can only achieve change if they are willing to change. – Engagement provider

In interviews with companies, clear differences could be observed in the initial stance of a company vis-à-vis engagers. Four of 10 investee companies seemed to have a more defensive and less open stance. They viewed the engagers as less knowledgeable on the discussed topic than the company itself and challenged the claims of the engagers, for example, by commissioning their own research. Other companies were more welcoming to engagers and stated that engagement is an important tool in gaining insight into their performance and into areas in which they could improve.

As a factor closely related to openness, the positions and interests of other internal stakeholders and management also determine whether the engagers' demands are accepted.

Interviewees mentioned, for example, that a company with more ESG-minded management is more inclined to comply with a request made during the engagement process.

In the previous section, we identified urgency and deadlines as less relevant for the effectiveness of engagement. However, one investee company mentioned that urgency was relevant to the internal processes and deadlines within a company and that engagement during the time that CSR policies are under review increases the effectiveness of the former.

6. Conclusion and discussion: is engagement reaching its potential?

Our findings show that the networks steering engagement comprise a range of specialised actors in the economic sector, most notably fiduciary managers, asset managers, ESG data providers, co-operation platforms and service providers. Remarkably, actors in the societal and policy networks have a minor influence in the networks of engagement, and most of the involved economic actors do not consider them important in shaping engagement or stimulating pension funds. As we discuss below, these stances influence the effectiveness of engagement.

We see that shareholder salience is a useful starting point for answering our second research question regarding which factors determine the effectiveness of engagement. Factors related to legitimacy were identified as especially relevant, including thorough the preparation and linking of ESG issues with financial materiality. Factors related to urgency and power were considered notable but less important. This finding is consistent with the results reported by Gifford (2012) and Allen, Letourneau, and Hebb (2012).

However, by taking into account the perspectives of the engagers and the investees, we are able to reveal additional factors beyond legitimacy, power and urgency. As we noted in the introduction, previous studies have already touched upon the roles of companies in relation to engagement. Gifford (2012) noted the 'values of managers', and Ferraro and Beunza (2014) described how the openness of companies plays a role in selecting companies for engagement. Based on our interviews with the investees, we identify three subfactors concerning an investee's situation that influence the effectiveness of engagement:

- The openness and stance of the investee towards engagement;
- The positions and interests of internal stakeholders, such as managers, in relation to CSR; and
- Urgency in relation to the internal processes and deadlines within an investee organisation.

Second, the relationship between the engager and investee is also important. In the interviews with engagers and investees, three subfactors were identified:

- The type of contact between an engager and investee, e.g. does the contact, for example, occur in the form of letters, phone calls or face-to-face meetings;
- The persistence of engagement; and
- The cultural proximity between an engager and investee.

The importance of cultural proximity is consistent with the abovementioned findings of Bauer, Clark, and Viehs (2013) of a trend towards greater engagement within the home market. In contrast to their findings, however, our study suggests that proximity increases effectiveness. These conflicting results merit further research.

At this point in the discussion, our findings regarding the factors that enhance the effectiveness of engagement can be assessed in the context of the current organisation of engagement by Dutch pension funds, as discussed in this research. Thus, the following question can be posed: to what extent is the present implementation of engagement effective in improving ESG performance? We address this question by discussing four main points: 1) the role of the organisation of engagement, 2) the connection between financial materiality and ESG performance, 3) the low level of contact between engagers and the societal and policy networks, and 4) the selection of companies for engagement.

When we focus on the organisation and network of engagement, the specialised agencies in the economic network would be expected to increase legitimacy and therefore be an important facilitator of the effectiveness of engagement. Because specialisation should potentially lead to experienced and knowledgeable engagers, sharing knowledge should increase legitimacy, and co-operation should lead to a larger shareholder base and, therefore, greater power. However, the reported experiences of companies with engagement are mixed. Indeed, companies reported that engagement was sometimes well prepared by the engagers who had insight into the sector and specifics on the companies. However, engagement was also sometimes viewed as ill prepared and ad hoc. These contrasting views and experiences can be explained by the present implementation of engagement. Specialisation indeed leads to better preparation and therefore legitimacy, but the engagement policies of pension funds cover a wide range of topics, and engagement agencies must therefore execute many engagements over a wide range of companies, which leads to specialised and seasoned engagers but also to a loss of focus and lack of in-depth knowledge of the companies and sectors involved. Avetisyan and Hockerts (2017) observed similar results with respect to ESG data providers, as a consolidation in this sector has also led to a loss of in-depth ESG data.

Second, although combining improved ESG performance with financial materiality was considered effective, this combination was not always implemented in practice. In the interviews, it emerged that engagement is sometimes performed by different teams: one focusing on ESG themes and one focusing on financial themes. The diversity of organisational structures for implementing SRI was also identified by Juravle and Lewis (2009), who had different explanations for why institutional investors diverge in their organisational structure for SRI: differences in organisational values, different views concerning the relation between ecological and financial rationales, and educational backgrounds. Another possible explanation for the separation of financial and ESG engagement is that ESG engagement did not initially focus on adding (financial) value but was solely a precursor of exclusion, which made the integration of the two engagement teams less logical.

Third, in addition to pension funds, NGOs are also increasingly discovering and using capital markets to exert influence (Waygood and Wehrmeyer 2003; O'Rourke 2003a, 2003b). Guay, Doh, and Sinclair (2004) reported that NGOs can assume several roles in doing so, from being a shareholder themselves to advising and co-operating with institutional investors. However, few coalitions between pension funds and societal actors

such as NGOs actually formed. The interviewees provided several reasons for such low involvement, such as that pension funds avoid being perceived as taking a political stand by working with NGOs, and NGOs and pension funds use different types and formats of data that are not easily combined, potentially decreasing effectiveness because co-operation with NGOs could strengthen their power and legitimacy. NGOs can, for example, use media and public statements (power) to strengthen and back the societal case (legitimacy), and information from NGOs could increase the knowledge of engagers (legitimacy). In addition, links with policy goals and policy networks could potentially strengthen the legitimacy of engagements by focusing on topics with supportive regulatory frameworks, those for which regulation can be foreseen or those that have a strong political and societal case. An example of such linking could be the 'Montreal Pledge' (2014), in which investors pledged to begin carbon footprinting, which links to the Kyoto and Paris agreements and can serve as a basis for engagement regarding climate change.

Fourth, one of the key factors for effective engagement identified in the interviews is the openness of a company that is engaged. As only a limited number of engagement cases can be implemented, an important aspect of successful engagement will therefore be selecting companies that are open to engagement and have support from higher management for improving ESG performance. When we assess the present structure of engagement processes, this is not often the case, as engagement processes often focus on companies in the portfolio that are lagging with respect to ESG performance.

In conclusion, engagement does not always reach its full potential of improving the ESG performance of investees. Because the engagers we interviewed were well aware of the effectiveness of their engagement and the factors determining it, a salient question is why engagement is not more effective. Hamilton and Eriksson (2011) provided a potential explanation. In their study of Swedish pension funds, they noted that pension funds exclude or engage mainly due to reputational concerns. Thus, engagement may be more of a hygiene factor that is similar to the exclusion process, which is important to have in place regardless of the outcome. This tentative explanation would also explain our findings from the survey, interviews, and secondary data. For example, the annual reports on active ownership often focus on the number of engagement cases and their diversity in terms of themes and geography. Although milestones are cited, there has been little in-depth analysis of the effectiveness of engagement. The interviewees also did not mention that engagement is governed or evaluated by the end clients regarding its effectiveness. For pension funds, it seems that being able to list a wide range of engagements is more important than the actual outcome of these engagements. To elaborate on this tentative explanation, gauge how widely it applies and determine whether such motives change over time, more research would be needed.

To institutional investors who, for whatever reason, indeed wish to increase the effectiveness of their engagement activities, several recommendations can be made based on our findings. Investors attempting to reach their full potential could do so by enhancing their preparation and selection process and by focusing engagement on fewer companies and sectors. The existing co-operation among pension funds, asset managers and ESG service providers implementing engagement already strengthens engagement. However, if investors, such as pension funds and their engagers, strengthen co-operation with NGOs and align with policy initiatives, these steps could further enhance their legitimacy

and urgency and therefore the effectiveness of the engagement in stimulating ESG performance. These investors could thereby become more powerful agents of change in relation to ESG performance.

Notes

1. In newer versions of these reports, quantitative data on engagement and shareholder voting are combined. Therefore, presenting and extending trends separately for engagement through 2016 is not possible.
2. As section 3 shows, the actual engagement processes for Dutch pension funds can be implemented by different actors, such as the pension funds themselves, their asset managers or ESG service providers; therefore, we use the term 'engager' to refer to the actor(s) actually engaging with the investees.

Disclosure statement

No potential conflict of interest was reported by the authors.

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